

Hydropower Site Lease

On January 31, 2008, The State of Montana Board of Land Commissioners and Avista Corporation entered into a lease for the riverbed land beneath the Clark Fork River for the Avista Clark Fork Hydropower Project. The lease was entered into under the Hydroelectric Resources Act and the terms of the Settlement Agreement as approved by the Board of Land Commissioners at its October, 2007 meeting. The State received payment for the 2007 annual rents in the amount of \$4,000,000.00 on February 1, 2008, as provided in the Lease. The Department recommends that the Board ratify the executed Hydropower Site Lease for the Avista Corporation Clark Fork Project.

HYDROPOWER SITE LEASE

Pursuant to the Montana Hydroelectric Resources Act, Section 77-4-201, MCA, et seq., this Hydropower Site Lease ("Lease") is entered into effective as of January 1, 2007, (the "Effective Date") between the **STATE OF MONTANA, STATE BOARD OF LAND COMMISSIONERS**, (hereinafter referred to as the "Lessor"), whose address is P.O. Box 201601, Helena, MT 59620-1601, and **AVISTA CORPORATION**, a corporation organized under the laws of the State of Washington, ("Lessee"), whose address is 1411 East Mission Avenue, -P.O. Box 3727, Spokane, WA 99202-3727. The Lessor and the Lessee may be referred to herein singly as "Party" or jointly as "Parties."

RECITALS

A. The Lessee owns and operates the Clark Fork Project for which a new license was issued by the Federal Energy Regulatory Commission as FERC Project No. 2058 (the "FERC License"). (*Order Issuing New License*, 90 FERC ¶ 61,167 (2000)). The FERC License authorizes Lessee to operate and maintain the Noxon Rapids and the Cabinet Gorge Developments of the Clark Fork Project. The Clark Fork Project is located, in part, on the Clark Fork River in Bonner County, Idaho, and Sanders County, Montana. This Lease pertains to a portion of the Clark Fork Project located solely on lands owned by the State of Montana within Montana;

B. The original licenses for the Cabinet Gorge Project and the Noxon Rapids Project were issued by FERC on January 9, 1951 and May 12, 1955, respectively. From that time, until March, 2004, the Lessee believed that it had obtained all property rights from the State of Montana necessary for those projects and the Clark Fork Project;

C. In October, 2003, Richard Dolan and Denise Hayman commenced an action in U.S. District Court in Missoula, Montana against Lessee and other companies, which raised questions as to the ownership and uncompensated use of navigable riverbeds by the Lessee. In March 2004, Lessor intervened as a plaintiff in the action. (*State ex rel. Richard Dolan v. PPL Montana LLC, et al.*, Cause No. CV-03 167-M-LBE). The United States District Court ultimately dismissed the lawsuit due to lack of jurisdiction;

D. In November 2004, PPL Montana, LLC ("PPL Montana"), PacifiCorp and Lessee filed a declaratory judgment action in Montana First Judicial District Court, Lewis and Clark County as *PPL Montana, et al. v. State of Montana* (Cause No. CDV-2004-846) (the "Lawsuit") in order to determine its rights, if any, to utilize navigable riverbeds, without compensation to the State of Montana. In December, 2004, the State filed an Answer, Counterclaims and a Motion for Summary Judgment and alleged, among other things, that Lessee and other companies had an obligation under the provisions of the Montana Hydroelectric Resources Act, Mont. Code Ann. § 77-4-201, et seq., to compensate Lessor for the use of state-owned riverbeds being used for hydroelectric power generation purposes;

E. The Montana First Judicial District Court determined in the Lawsuit that the State of Montana owns the riverbed of the Clark Fork River in Sanders County, Montana in trust for Montana's common public schools, and therefore has a duty to obtain the full market value of that use by the Lessee. Therefore the State is entering into this lease to comply with the State's trust duty to obtain the full market value for the disposition of any interest in State school trust lands;

F. Pursuant to the Memorandum of Negotiated Settlement Terms signed on October 19, 2007, and the Consent Judgment entered on November 19, 2007, the Lessor and Lessee agreed to resolve all claims made in the Lawsuit through the issuance of the following lease by the State Board of Land Commissioners;

Wherefore, the Parties hereby agree to the following:

LEASE TERMS

1. **Leased Premises.** Subject to all the terms and conditions contained herein, the Lessor hereby leases to the Lessee and the Lessee hereby leases from the Lessor those lands below the Clark Fork River for which Avista has not already acquired a right of use within the Clark Fork Project in Sanders County, Montana (the "Leased Premises") as more particularly described in **Exhibit A**, for the following term described herein.

2. **Lease Term.** The term of this Lease ("Term") will be deemed to have commenced on January 1, 2007, and will terminate on the earlier of: (a) February 28, 2046; or (b) the termination of the FERC License.

3. **Payment Date.** On or before the first day of February of each year ("Payment Date"), Lessee will pay to Lessor an annual rent ("Rent") for occupying the Leased Premises during the preceding calendar year during which the Lease is in effect. If the first day of February is a Saturday, Sunday, Montana or federal holiday, the payment will be due on or before the next following business day.

4. **Rent.** The amount of the Rent shall be determined as follows:

4.1. On or before the Payment Date of February 1, 2008, the Lessee will pay to the Lessor the sum of Four Million and 00/100 Dollars (\$4,000,000.00) ("Base Rent") as Rent for the Leased Premises for the year 2007.

4.2. Thereafter, continuing on February 1st of each subsequent year (the "Adjustment Date") during the Term of this Lease, the Lessee will pay to the Lessor an adjusted annual Rental for the prior year, calculated as follows:

4.2.1 The base ("Base Index") for computing the adjustment is the Consumer Price Index for the month of January 2007 (the "Index Date") as shown in the Consumer Price Index ("CPI") for all Urban

Consumers/All Items, based on the latest year used as a base year by the U.S. Department of Labor's Bureau of Labor Statistics.

4.2.2 The index for the Adjustment Date will be computed as a percentage of the Base Index (the "Percentage Adjustments"). For example, assuming the Base Index on the Index Date is 200 and the index figure on the Adjustment Date is 210, the Percentage Adjustment to be applied is 210 divided by 200, yielding 105%.

4.2.3 The Rent for the period beginning on the Adjustment Date and continuing until the next Adjustment Date will be equal to the Base Rent plus the Percentage Adjustment. For example, if the Percentage Adjustment for year 2008 is 105%, Rent for year 2008 would be the product of \$4,000,000 as multiplied by 105%, which equals \$4,200,000.00.

4.2.4 If the CPI is no longer published, another comparable index, generally recognized as authoritative ("Substitute Index") will be substituted by agreement of the Parties. If the Parties are unable to agree on a Substitute Index within thirty (30) days after demand by either Party, either Party may apply to the chief officer of the Research & Analysis Bureau of the Workforce Services Division of the Montana Department of Labor & Industry, or its successor or equivalent, to select the Substitute Index.

4.2.5 If the lease terminates or Avista's obligation to pay rent ceases prior to the end of any calendar year, Rent will be prorated taking into account the portion of the year during which the Lease is in effect.

4.3 Not later than June 30, 2016, the Parties will meet and confer to determine whether the annual Rent as determined herein remains consistent with the principles of law as applied to the facts. In the event either Party believes the annual Rent is no longer is consistent with applicable law applied to the facts, the Parties will negotiate in good faith to determine an appropriate adjusted rental rate.

4.4 If the parties do not agree upon an adjusted rental rate by September 30, 2016, the parties will engage in advisory arbitration and submit the arbitrator's recommendation to the Board of Land Commissioners for approval.

4.5 All payments required by this Lease will be made to the Montana Department of Natural Resources and Conservation, 1625 Eleventh Avenue, P.O. Box 201601, Helena, MT 59620-1601, or to such other payee as designated in writing by the State of Montana.

4.6 Parties agree that Rent as determined in accordance with this Lease is the full market rental value of the Leased Premises for the Term of this Lease.

4.7 In the event of a dispute over rental amounts, rental payments made shall be made by the Lessee under protest. Any rental payments made under protest shall be placed in an interest-bearing escrow account by the Lessor. The rate of interest shall be equal to the rate of return of the unified investment program administered by the board of investments pursuant to §17-6-201, MCA. The validity of any payment made under protest shall be resolved by a MAPA contested case hearing as provided by paragraph 10 of this Hydropower Site Lease. The prevailing party in any such rental dispute will be entitled to the disputed rentals as well as the interest accrued upon those rentals.

5. **Reopeners.** The Parties agree that the amount of Rent due under this Lease may be reopened and adjusted if any of the following events occur:

5.1 **Most Favored Nations Clause.** If, co-party to the Lawsuit, PPL Montana, either by litigation through judgment and any appeals, or through settlement, receives a determination that the full market rental value of its land interests at issue in the litigation is based upon factors, that if applied to Lessee, would result in a more favorable rental rate than the Rent established by Sections 4.1, 4.2 and 4.3 of this Lease, then the Rent will be adjusted by an amount necessary to reflect the more favorable determination. For purposes of this clause, a more favorable determination will occur if the aggregate annual rent determined for PPL Montana by settlement or litigation ("Determined PPL Rent") is less than 48% of the aggregate amount of base year rent claimed by Lessor in its case in chief against PPL Montana ("Claimed PPL Rent") in the Lawsuit. In the event of a more favorable determination, the \$4 million base annual Rent established by Section 4.1 of this Lease to be paid by Lessee will be reduced retroactively starting on the date of final judgment on the PPL Montana claims, or date of settlement, by a percentage equal to the Determined PPL Rent divided by the Claimed PPL Rent. (See Exhibit B for an illustration of the calculation.)

5.2 **Reopener for Subsequent Governmental Action.** If, during the Term of this Lease, the Board of Land Commissioners, the Montana Legislature, the Department of Natural Resources and Conservation, or any other State entity with jurisdiction, enacts or adopts a rental statute, rule, or policy applicable to leases issued under the Hydroelectric Resources Act that would result in a rent payment more favorable to Lessee, then the Rent shall be modified retroactively starting on the date of enactment or adoption to incorporate the more favorable terms.

5.3 **Reopener for Subsequent Judicial Determination.**

5.3.1 If, during the Term of this Lease, the reach of the Clark Fork River within the boundaries of the Leased Premises is determined by a court of competent jurisdiction to be not navigable for title purposes, or that the State of Montana otherwise does not have title to the riverbed of the Clark Fork River in Sanders County, Lessee's obligation to pay Rent shall cease.

5.3.2 If, during the term of this Lease, a court of competent jurisdiction determines that compensation in the nature of rent owed to the State is less than what is set forth in this Lease, Lessee's obligation to pay Rent will be reduced from the date of determination to reflect a method of calculating Rent that is consistent with the court's determination.

6. **Assignments.** This Lease is assignable by the Lessee only with the prior written approval of the Lessor. However, the the Lessor shall approve assignment of this lease to any successor-in-interest to the above-described FERC license who possesses the apparent financial ability to carry out the lessee's duties under this lease.

7. **Improvements.** The Lessee is authorized to construct, operate and maintain any and all improvements ("**Improvements**") necessary to conduct the operations described in the above-described FERC License, as such license may be amended from time to time. Lessor and Lessee acknowledge that ownership of any Improvements following the end of the Term shall remain with Lessee, subject to the provisions of the Federal Power Act and any interests of the United States.

8. **Indemnification.** As a condition of the grant the above-described Lease, the Lessee, and its successors and assigns, hereby agree to indemnify, defend with counsel acceptable to the State, and hold harmless the State of Montana, the State Board of Land Commissioners, the Montana Department of Natural Resources and Conservation, and their officers, agents, employees, and representatives from and against all claims and liabilities arising in whole or in part or in any manner out of the Lessee's design, placement, allowance, existence, construction, inspection, public use, operation, and maintenance of any improvements upon the above-described lands, including all repairs, restoration and rebuilding made at any time thereafter, whether or not due to the alleged negligence of the state. This duty to defend and indemnify shall extend to all actions, administrative proceedings, judgments, damages, punitive damages, penalties, fines, costs, liabilities, interest, or losses, sums paid in settlement of claims, attorney's fees, consultant fees, expert witness fees, as well as any fees, costs, or expenses incurred by the State in enforcing this indemnity. Notwithstanding anything to the contrary in this paragraph, the Lessee shall have no liability for losses to the extent they are caused by or result from the actions or omissions of Lessor. The duty to defend and indemnify shall survive the termination of the above-described Lease.

9. **Control and Design Indemnification** - During the existence of the above-described Lease, the Lessee, and its successors, and assigns, shall have control and possession of the above-described Property for hydropower purposes, and the State shall have no liabilities, obligations or responsibilities whatsoever with respect thereto or with respect to any plans or specifications submitted to any Governmental Authority. The State is not the agent of the Lessee and the Lessee is not the agent of the State. Any review of such plans or specifications by the Lessor is solely for its own purposes, and the Lessor expressly disclaims any warranty concerning the appropriateness of any such plans or specifications for any purpose. The Lessee hereby covenants and agrees to indemnify, defend with counsel acceptable to the State, and hold the State of Montana, the State Board of Land Commissioners, the Montana Department of Natural Resources and Conservation, and their officers, agents, employees, and representatives harmless from and against any and all claims arising in whole or in part or in any manner out of the design or the use of such plans and specifications, whether or not due to the alleged negligence of the state. Notwithstanding anything to the contrary in this paragraph, the Lessee shall have no liability for losses to the extent they are caused by or result from the actions or omissions of Lessor. The duty to defend and indemnify shall survive the termination of the above-described Lease.

10. **Breach and Reversion and Remedies.** The Lessee's failure to pay the above-described rental by the due date or the Lessee's breach of any other duty or condition under this Hydropower Site Lease, shall result in the ~~termination~~ cancellation of the above-described Lease, and the reversion of the Leased lands to the State. However, prior to any cancellation, the Lessee shall be given written notice of such breach and 30 days opportunity to cure the breach before the cancellation shall become effective. Should any dispute arise as to the Lessee's duties under this Hydropower Site Lease, it shall be given the opportunity for a contested case hearing under the Montana Administrative Procedures Act, §§2-4-601, MCA before the Montana Department of Natural Resources and Conservation. In such instances, the term of this Hydropower Site Lease shall be extended until a court of final jurisdiction reviews the outcome of the MAPA hearing.

11. **Taxes.** The intent of both parties is that this Lease shall not ~~result in a~~ affect any tax payments or assessments owed by the Lessee, and by entering into this Hydropower Site Lease, the Lessee does not waive any rights or obligations as to the payment of taxes.

12. **No Warranty of Title.** It is understood and agreed that this lease is issued only under such title as the State of Montana may now have or hereafter acquire, and, other than a reduction in rent due as provided in paragraph 5.3 above, that the Lessor shall not be liable for any damages sustained by the Lessee in the event the Lessor does not have the title to the leased lands or the Lessee is found to have possessed a prior right or easement for its operations upon the leased lands described herein.

13. **Interference.** The Parties recognize that the leased premise is a public waterway of the State of Montana and subject to the rights of the public for the recreational use of streams. The Lessor further reserves the right to issue additional leases for the use of the above-described lands, provided that such leases and uses shall not in any manner interfere with the Lessee's operation of the Clark Fork Project. Lessor will notify Lessee in writing prior to granting any third party the use or occupy any portion of the Leased Premises for any purpose. Lessor also will not use, nor will Lessor permit its employees, lessees, licensees, or agents to use, any portion of the Leased Premises in any way, which interferes with the operations of Lessee or the rights of Lessee under this Lease or the FERC License. Lessor will cause such interference to cease within forty-eight hours after written receipt of notice of interference from Lessee. In the event any such interference does not cease within the cure period then the Parties acknowledge that Lessee will suffer irreparable injury, and Lessee will have the right, in addition to any other rights that it may have at law or in equity, to elect to enjoin such interference upon notice to Lessor.

14. **Miscellaneous.**

14.1 **Amendment/Waiver.** This Lease cannot be amended, modified or revised unless done in writing and signed by an authorized agent of Lessor and an authorized agent of the Lessee. No provision may be waived except in a writing signed by both Parties.

14.2 **Binding Effect.** The terms and conditions contained in this Lease will run with the Leased Premises and bind and inure to the benefit of the Parties, their respective heirs, executors, administrators, successors and assigns.

14.3 **Entire Agreement.** This Lease and the Consent Judgment attached hereto as Exhibit C, all being a part hereof, constitute the entire agreement of the Parties hereto.

14.4 **Governing Law.** This Lease will be governed by and construed according to the laws of the State of Montana.

14.5 **Force Majeure.** If either party is prevented from complying with any terms or provisions of this Hydropower Site Lease due to impossibility, including, but not limited to, riot, war, rebellion, accident, or other causes beyond the control of such party, then upon written notice to the other party, the affected provisions or requirements of this Hydropower Site Lease shall be suspended during the period of such disability.

14.6 **Notice.** When notice is required under any of the terms of this agreement, notice shall be made to the following address and each party will further notify the other when there is any change in the address listed here:

For the State of Montana:

Director, Department of Natural Resources and Conservation
State of Montana
1625 Eleventh Avenue
P. O. Box 201601
Helena, MT 59620-1601

For Avista Corporation:

President, Avista Corporation
1411 East Mission Avenue
P.O. Box 3727
Spokane, WA 99202-3727

Additional copy to:
Registered Agent, State of Montana, for Avista Corporation.

LESSOR
STATE OF MONTANA:

By: Mary Sexton

Its: Director

STATE OF MONTANA)
: ss.
County of LEWIS & CLARK)

This instrument was acknowledged before me on January 30, 2008 by Mary Sexton, Director of the Montana Department of Natural Resources and Conservation, for the State Board of Land Commissioners, on behalf of whom instrument was executed.

IN WITNESS WHEREOF, I have hereunto set my hand and notary public seal the day and year first above written.

(SEAL) Stephanie P. Kellogg
Printed or typed name: STEPHANIE P. KELLOGG
Notary Public for the State of Montana
Residing at Caney, Montana
My commission expires: 08/31/2009

LESSEE
AVISTA CORPORATION:

By: Scott L. Main
Its: CEO / President

STATE OF WASHINGTON)

: ss.

County of Spokane

This instrument was acknowledged before me on January 31, 2008 by
Scott Morris as Pres / CEO / Chairman of Avista Corporation, on
behalf of whom instrument was executed.

IN WITNESS WHEREOF, I have hereunto set my hand and notarial seal the day
and year first above written.

David Meyer
Noted or typed name:
Notary Public for the State of Washington
Residing at Spokane, Washington
My commission expires: Feb 11, 2012

(SEAL)

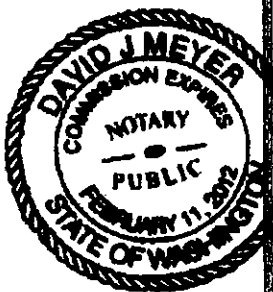


EXHIBIT "A"

DESCRIPTION OF LEASED PREMISES

The leased premises include 3,158 acres, more or less, which the parties stipulate represents the area of streambed below the water of the Clark Fork River and bounded by the low water mark, running between the upstream boundary of the Clark Fork Project to the downstream boundary of the Clark Fork Project. The Clark Fork Project is described by the maps, plans, specifications, and statements described and designated as exhibits that are on file with and approved by the Federal Energy Regulatory Commission as part of the license for the Clark Fork Project, Project No. 2058. The Project lies generally within the following Sections:

Township 27 North, Range 35 West, MPM

Section: 24

Township 27 North, Range 34 West, MPM

Sections: 18, 19, 20, 21, 25, 26, 27, 28, 33, 34, 35, and 36

Township 27 North, Range 33 West, MPM

Sections: 30, 31, and 32

Township 26 North, Range 33 West, MPM

Sections: 3, 4, 5, 8, 9, 10, 13, 14, 15, 23, and 24

Township 26 North, Range 32 West, MPM

Sections: 18, 19, 20, 29, 32, and 33

Township 25 North, Range 32 West, MPM

Sections: 3, 4, 5, 9, 10, 11, 14, 15, 22, 23, 26, 27, and 28

Township 24 North, Range 32 West, MPM

Sections: 1, 2, 3, 4, 10, 11, 12

Township 24 North, Range 31 West, MPM

Sections: 6, 7, 8, 9, 14, 15, 16, 17, 18, 21, 22, 23, 25, 26, 27, 35, and 36

Township 24 North, Range 30 West, MPM

Section: 31

Township 23 North, Range 30 West, MPM

Sections 5, 6, 7, 8, 16, 17, 18, 21, 26, 27, 28, 34, and 35

Township 22 North, Range 30 West, MPM

Sections: 3, 10, 11, 13, 14, 23, 24, 26, 35, and 36

Township 21 North, Range 30 West, MPM

Section: 1

Township 21 North, Range 29 West, MPM

Sections: 6 and 7